THE WHITE HOUSE

WASHINGTON

June 3, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the June 5 Meeting

The agenda and papers for the June 5 meeting of the Economic Policy Council are attached. The meeting is scheduled for 1:00 p.m. in the Roosevelt Room.

The first agenda item is an overview of U.S.-E.C. trade relations. During the coming weeks and months the United States and the European Economic Community will need to resolve a number of important trade issues: U.S. citrus exports, disagreements over E.C. steel pipe and tube exports, renegotiation of the U.S.-E.C. steel arrangement, agricultural export subsidies, E.C. proposals to protect emerging high technology industries, and E.C. proposed tariff increases in return for lower tariffs for Spain and Portugal when they join the E.C.

Rather than consider these individually, the first agenda item is designed to serve as an overview discussion of what are our goals, priorities, and strategy for achieving our objectives with respect to U.S.-E.C. trade relations. The Office of the U.S. Trade Representative has prepared a paper entitled "U.S.-E.C. Trade: Conflicts on the Horizon," which is attached.

The second agenda item concerns the Section 301 Citrus case. The President must decide by June 20 on what action, if any, to take in response to the European Community's practice of discriminating against U.S. exports of citrus products. A memorandum on this issue is also attached.

In the wake of this morning's Economic Policy Council discussion, the Office of the U.S. Trade Representative is preparing additional papers on the range of trade policy legislation and other activities during the coming months and on our overall trade policy strategy. These papers will be circulated to Council members as soon as they are completed.

Unclassified with confidential attachment

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

June 5, 1985

1:00 p.m.

Roosevelt Room

AGENDA

1. U.S.-E.C. Trade Relations

2. Citrus Section 301 Petition

Approved For Release 2010/05/13 : CIA-RDP87T00759R000100170022-5

U.S. - EC TRADE: CONFLICTS ON THE HORIZON

PROBLEM

Over the coming weeks, the Administration must deal with trade problems with the European Community that will directly affect U.S. agricultural exporters and domestic steel producers, and will have a lasting impact on the viability of the GATT as an instrument for resolving trade disputes. Our present conflicts with the Community are worrying not simply because of their short-term impact on our trade interests, but because they are symptomatic of a fundamental divergence in perspectives and goals vis-a-vis the international trade system.

SITUATION

While public and Congressional attention has largely been focused on U.S.-Japan trade frictions, trade relations with the Community have sharply deteriorated, almost unnoticed. The list of divisive issues is lengthy: the EC's decision to block adoption of the GATT panel's report in the citrus case; lingering disagreements over the application of the short supply provisions of our steel pipe and tube Agreement with the Community; tensions surrounding the Carbon Steel Arrangement, which expires this Fall; EC resistence to tighter restrictions on agricultural export subsidies; Community flirtation with tariff increases on certain consumer electronics products; possible hikes in EC tariffs as a result of the accession of Spain and Portugal.

Our trade relationship with the EC over the coming year, and our ability to garner private sector support for a New Trade Round, depend in large part on how we handle these disputes with the European Community.

THE ROOTS OF CONFLICT

Serious as they are, **these disputes reflect deep divisions over trade policy between ourselves and the Community that are even more troubling.** EC trade policy seems riveted to the status quo: it is not prepared to consider changes in the Common Agricultural Policy; it fears negotiations on high technology trade because many Member States believe we want to limit subsidies and infant industry protection, tools they believe are essential to catching up with us and the Japanese; finally, the Community's resistence to change, particularly in agriculture, is increasingly bringing it into conflict with the GATT, where it refuses to play by the rules if found in violation of them.

At root, the European Community, with the exception of the United Kingdom and, perhaps, Germany, fears trade liberalization because many in Europe do not believe they could compete without protection. The Community is looking at trade policy through a blast furnace: shocked by the political, social and financial cost of restructuring an industry like steel that had been too long insulated from competition, but lacking the self-confidence to rely too heavily on competitive pressures and free markets to

stimulate new efficient industries. Clearly there are differences on these issues among EC members, but **the Community's decision-making process tends to produce a lowest common denominator approach.** As a result, market-opening initiatives have little chance of surviving internal debate (e.g., the United Kingdom's unsuccessful attempt to drop semiconductor tariffs).

The specific problems listed below, each of which may call for U.S. trade action in the near future, are manifestations of the deeper trade policy divisions between the U.S. and the EC.

Most of the problems confronting the U.S.-EC trade relationship are not new. The citrus case has been with us in one form or another for nearly 17 years. Community steel exports to the United States have been a persistent source of friction, even in those areas covered by bilateral arrangements limiting EC shipments. We have long disagreed about the use of subsidies in international agricultural trade. An infant industry approach to protecting nascent high-tech industries is not novel for the EC, nor is our opposition to it. Community enlargement, which we have always supported on political grounds, has become a progressively more contentious trade issue during the past five years as the EC endeavors to use the accession of new members as an occasion for extracting trade "credits" from us.

That these disputes should simultaneously demand attention now is chiefly an accident of circumstances. We can't afford to be misled by their longevity, however, to think that we can ignore them much longer without paying a price.

CITRUS AND GATT DISPUTE SETTLEMENT

The citrus panel report was blocked by the EC in April. The Administration decided during that month that it must act, withdrawing equivalent trade concessions, in the absence of a settlement. Although some procedural steps were delayed until after the Bonn Summit, we plan to recommend to the President on May 30 that he implement the withdrawals. Under domestic law he will have until June 20 to act on the recommendation. Withdrawing concessions creates the risk of counter-retaliation by the EC, however not to act promptly carries risks of its own. The failure of the GATT process to produce meaningful results in dealing with our four agricultural cases with the EC (pasta, canned fruit and raisins, wheat flour, citrus) has badly eroded the confidence of our agricultural community in the GATT and in our trade policy. Failure to act in this case would signal other sectors as well that we will allow our trading partners to frustrate the GATT dispute settlement process with impunity. This would be a disastrous message to send to Congress and to U.S. exporters. This case epitomizes our recent experience with the EC in the GATT: where the Community is found in violation of the rules it nevertheless refuses to alter policies, or even to accept that its trading partners have the right to withdraw concessions.

STEEL: GETTING TO THE NEGOTIATING TABLE

France and Germany are pushing us to apply the "short supply" provisions of the new U.S.-EC Pipe and Tube Agreement to some of their shipments for pipeline projects in the U.S. The French argue that we gave assurances on this point before the Agreement was concluded. **In fact, the opposite is true.** This argument is proceeding in tandem with discussions of dramatically increased Community shipments of steel products covered by the "consultation" provisions of the 1982 Carbon Steel Arrangement. The diversion of EC exports away from products requiring licenses under the Arrangement to the "consultation" products could accelerate as we near the end of the Arrangement's life this Fall. Presumably EC exporters will try to build as large a sales volume as possible in order to maximize their share of EC quotas in any future Arrangement. The resulting surge in exports would make negotiation of a new agreement extremely difficult for us. Therefore, efforts are now being made to get an EC commitment to start negotiations soon and to bring shipments of consultation products under control. Limited U.S. concessions on pipe and tube have been offered as an incentive for the EC to come to the table, but trade action, i.e., countervailing duty (CVD) or antidumping (AD) cases, may ultimately be required before the Community is able or prepared to negotiate.

AGRICULTURAL EXPORT SUBSIDIES

Although the strong dollar has eased the burden of export subsidies on EC coffers, the European Community, under French inspiration (but with strong support from the Irish, Greeks, Italians and even the Germans), is resisting our efforts to negotiate tougher discipline over the use of agricultural export subsidies. Since the Tokyo Round, but particularly during the past five years, we have discussed this problem bilaterally with the EC as well as multilaterally. There has been no significant progress. Judging by President Mitterrand's statements at the Bonn Summit, and Madame Cresson's recent comments in Washington, France is trying to stiffen Community opposition even to talking about tighter control over these subsidies. Meanwhile, we are losing credibility with our own exporters, who don't believe negotiations will solve this problem. They are likely to back farm legislation that will try to force the Administration to support U.S. exports more aggressively, e.g., through our own export subsidies. Furthermore, they will be skeptical that the New Trade Round will make any progress on this issue.

PROTECTION FOR EMERGING HIGH TECH INDUSTRIES

Recently, the EC's Industry Council considered a proposal to increase tariffs on certain consumer electronics items. The idea had some support from the previous EC Commission (especially former Industry Commissioner Davignon), and is attractive to those who believe that some form of infant industry protection is

necessary if new European high tech industries are to have a chance to catch up with their U.S. and Japanese competitors. We initially assumed the proposal was aimed at Japan, but subsequently found that one version would hit about $500 million in U.S. mini-computer exports. Following our protest, the idea has reportedly been shelved. However, in light of the EC's doubling of the tariff on digital audio disks (DAD's) last year using a similar argument, increased protection in the EC's high tech sector is a continuing threat.

Recent French efforts to make sure that a major computer purchase by the Ministry of Education is steered to a French manufacturer are another manifestation of a protectionist approach to high tech industries. We are taking on this case in the GATT Procurement Code.

We oppose this sort of protection in principle and doubt that it is effective in practice: given the pace of change in the high tech area, industries developing under a protective umbrella are unlikely ever to be competitive. They will be perennial candidates for protection. Moreover, if the Community resorts to this approach it will gain currency elsewhere, raising the overall level of protection facing high tech products in world markets.

Many in the Community, on the other hand, are obsessed with the notion that only a combination of subsidies, protection, and heavy government (or EC Commission) intervention will enable the EC to catch up with the U.S. and Japan in high technology industries.

COMMUNITY ENLARGEMENT AND THE TRADE CREDIT

In negotiations with us to sort out the impact on U.S. trade of the accession of Greece to the EC (1981), the Community tried to collect a trade "credit", i.e., the right to increase certain EC tariffs. The Community's argument, which we rejected, was based on the notion that enlargement produced benefits for us in the form of lower Greek tariffs, and that the EC therefore ought to be allowed to raise some tariffs to balance accounts. We pointed out that the GATT does not permit this sort of "credit," presumably because it recognizes that the real trade benefits of enlargement go to the members of the existing European Community, which will enjoy free access to the markets of the new member states, displacing at least some exports from non-EC countries.

The stakes involved were minor in the case of Greek accession. When Spain and Portugal join the EC, probably January 1, 1986, the ante will go up: the Community may try to extract a tariff "credit" covering up to $700 million in trade. We are particularly concerned that EC tariffs might be raised on some of our agricultural exports, e.g., corn gluten, that now enter the Community duty free as a result of our previous negotiations. EC Member States and the Commission have been warned repeatedly not to try collecting a tariff "credit" in connection with the upcoming enlargement.

Even if the Community abandons its tariff "credit" claims, the enlargement will have a major long-term impact on our agricultural exports. We will lose markets in Spain and Portugal as they move behind the protection of EC variable levies, and Spanish production of crops, e.g., grains, that will compete with our remaining sales to the EC, and our exports to third countries, will no doubt increase under the influence of the CAP.

The common wisdom in the Community, of course, is that current EC Member States will pay a heavy price, in financial terms and (in the cases of Greece, Italy and France) in the form of increased competition in "Mediterranean" agricultural products, for admitting Spain and Portugal. The argument that enlargement is really being done for political reasons, i.e., to enhance Western security, easily gives rise to the European conviction that we should bear a "fair" share of the burden. At this point the EC's concept of a fair share goes well beyond what we think reasonable.

THE U.S.-EC MONOLOGUE

With all these problems either looming on the horizon or already upon us, we need a senior contact in the Commission with whom we can have a constructive dialogue. Unfortunately, the new EC Commission has not been receptive. External Affairs Commissioner Willy DeClercq seems to rely on individuals whose personal biases and emotional involvement in the issues that divide us make them unsatisfactory interlocutors, and whose advice appears to be coloring his judgement. DeClercq, in fact, is reportedly inclined to revive the specter of restrictions on our corn gluten exports, just when the issue appeared to have lost momentum. Efforts by U.S. Cabinet officers to develop a close working relationship with DeClercq have **not** produced the kind of easy rapport needed for more informal exchanges.

We don't yet know whether any of the new Commissioners will ultimately be able or willing to allow a relationship with us that will open up productive informal lines of communication. For the moment, Leslie Fielding, Director General for External Affairs, is about the only senior official with whom we seem able to have a relatively dispassionate dialogue on trade problems. Unfortunately, Fielding does not seem to wield enough influence within the Commission to be very helpful, even when he is disposed to be. Another major problem we encounter with Fielding is that he takes very seriously <u>his</u> claim that he is the "vicar of EC foreign policy." As a result, he doesn't find time to do his trade "homework."

Thus, at a critical moment in U.S.-EC trade relations, we find ourselves without an interlocutor in the European Commission.

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

May 30, 1985

MEMORANDUM FOR THE PRESIDENT

FROM: Michael B. Smith, Acting

SUBJECT: Determination Under Section 301 of the Trade Act of 1974 Regarding Discriminatory Tariff Treatment by the European Economic Community on Imports of U.S. Citrus Products

You must decide by June 20 what action, if any, to take in response to the European Community's (EC's) practice of discriminating against U.S. exports of citrus products. An international dispute settlement panel found that this practice distorts conditions of competition in the EC market with respect to trade in oranges and lemons and recommended that the EC reduce its most-favored-nation tariff rate, thus reducing the degree of discrimination. However, the EC has refused to accept the panel's finding or recommendation or to negotiate a compromise solution.

Section 301 gives you broad discretionary authority to respond to foreign practices which deny benefits to the U.S. arising under a trade agreement or which are otherwise unreasonable or discriminatory and restrict U.S. commerce. For the reasons set forth below and described more fully in the attached background document, I am recommending that you exercise this authority in a moderate way by imposing increased duties on U.S. imports of pasta products from the EC until such time as the citrus issue is resolved or the EC provides adequate compensation. This measure will restore the balance of concessions in U.S.-EC trade and will demonstrate a firm yet flexible response to unfair trade practices. The EC will react adversely to this duty increase. Moreover, because the EC has blocked acceptance of the panel's findings, our action will be taken without GATT authorization. Nevertheless, I believe action is necessary both to re-balance the level of U.S.-EC trade concessions and to meet your commitment to respond to unfair trade practices especially in the agricultural sector.

This recommendation has the support of the Departments of Agriculture, Commerce, Justice, Labor, and Treasury as well as the Office of Management and Budget and the Council of Economic Advisors. The Department of State has not taken a position on the recommendation.

If you approve this recommendation, we will prepare a proclamation to implement your decision.

_____ Approve (Sign Memorandum at Tab A)

_____ Disapprove

Background

Based on petitions filed in 1976 by the Florida Citrus Commission, California-Arizona Citrus League, Texas Citrus Mutual, and Texas Citrus Exchange, USTR initiated an investigation concerning the EC's tariff treatment of U.S. citrus exports. As a result of this investigation, we have found that as part of broad preferential trading agreements, the EC has, since the late 1960's, levied a lower duty on imports of citrus from the Mediterranean countries, than that levied on imports from the U.S. The level of discrimination is significant. In some cases the U.S. pays a duty five times greater than that paid by other suppliers. This discriminatory tariff treatment has impaired the ability of U.S. citrus exporters to market their fruits in the EC and, in our view, is inconsistent with the EC's obligations under international trading rules.

Nevertheless, recognizing the political importance to the EC of the EC-Mediterranean agreements, the U.S. made extensive efforts over a period of years to resolve this issue through bilateral discussion rather than mount a legal challenge to EC practices. The EC, however, rebuffed all such efforts.

The Trade Policy Committee therefore decided, in November, 1981, to challenge the EC's citrus preferences under the rules and procedures of the pertinent international trade agreement, the GATT. In January, the panel of experts appointed by the GATT to examine the U.S. complaint found unanimously that the EC practices had distorted competitive conditions with respect to two key U.S. exports, oranges and lemons. The panel recommended that the EC reduce the most-favored-nation rate of duty on these items. The EC, however, has refused to accept the findings and has effectively blocked further action on the matter in the GATT. The U.S. made further efforts to resolve the issue bilaterally: Secretary Brock personally urged Willy De Clercq, the EC Commissioner for External Relations and Commercial Policy, to seek a compromise solution, and Secretary Schultz sent letters to his counterparts in the EC Member States indicating our willingness to negotiate a reasonable solution and warning of the likelihood of unilateral action by the U.S. if no resolution is reached. The EC again rejected the U.S. overtures.

As a result of the EC's unfair practices on citrus products, the level of trade concessions between the U.S. and EC is no longer in balance. Because the EC will not implement the dispute settlement panel's recommendation or otherwise provide adequate compensation, the U.S. must act to re-balance the level of trade concessions. This can be accomplished by imposing increased duties on imports of EC products equivalent to the damage our exporters incur from the EC discriminatory tariffs.

I therefore recommend that you proclaim an increase in duty on pasta imports from the EC to a level of 40% ad valorem on pasta not containing egg and 25% ad valorem on pasta containing egg. This duty increase is a very moderate response to the EC's unfair practice. The value of concessions being withdrawn (approximately $30 million) is conservative compared with the $48 million estimated annual trade damage to the U.S. citrus industry resulting from EC preferences. Moreover, the duty increase could be rescinded at such time as the EC modifies its practice with respect to citrus or otherwise compensates the U.S. The selection of pasta for this action is appropriate because pasta was the subject of an earlier U.S.-EC trade dispute in which the EC also blocked a GATT decision favorable to the U.S. Because the EC has blocked further action in GATT, the U.S. does not have GATT authorization to take this measure. Thus we run the risk that the EC will accuse the U.S. of ignoring our own international obligations, or that the EC will retaliate by restricting imports of other U.S. products.

However, we believe we have no choice but to take that risk. We cannot credibly defer action to allow further time for negotiation, because the EC has consistently, clearly and publicly rejected the possibility of a negotiated solution. In these circumstances, failure to act will have adverse implications for both domestic and international trade policy. An essential corollary of our efforts to resist protectionist pressures is our commitment to combat unfair foreign trade practices and to seek improved international rules. While actual trade levels involved in the citrus case are relatively small, failure to act will impair the credibility of an approach dependent on international rules and could be used domestically as a symbol of our unwillingness to respond to unfair practices and will encourage those in Congress who prefer to administer trade policy through legislation. Inaction in the face of the EC's refusal to respect panel findings will also encourage other countries to flout international rules.

Memorandum of Determination Under Section 301
of the Trade Act of 1974
Memorandum to the United States Trade Representative

Pursuant to Section 301(a) of the Trade Act of 1974, as amended (19 U.S.C. 2411(a)), I have determined that the preferential tariffs granted by the European Economic Community (EEC) on imports of lemons and oranges from certain Mediterranean countries deny benefits to the United States arising under the General Agreement on Tariffs and Trade (GATT), are unreasonable and discriminatory, and constitute a burden and restriction on U.S. commerce. I have further determined that the appropriate course of action to respond to such practices is the withdrawal of equivalent concessions with respect to imports from the EEC. I will therefore proclaim an increase in duties on pasta products classified in items 182.35 and 182.36 of the Tariff Schedules of the United States imported from the EEC. This action has been necessitated by the unwillingness of the EEC to negotiate a mutually acceptable resolution of this issue. At such time as the United States Trade Representative makes a determination that a mutually acceptable resolution has been reached, I would be prepared to rescind this measure.

Reasons for Determination

Based on petitions filed by the Florida Citrus Commission, the California-Arizona Citrus League, the Texas Citrus Mutual and

the Texas Citrus Exchange, the United States Trade Representative initiated an investigation in November, 1976 concerning the EC's preferential tariff treatment with respect to citrus imports from certain Mediterranean countries. The petitions alleged that these discriminatory tariffs, which are granted in the context of broader trade agreements with the Mediterranean countries, are inconsistent with the most-favored-nation principle of the GATT and placed U.S. exporters at a competitive disadvantage in the EC market. Similar complaints had been filed by the U.S. industry in 1970 and 1972 under Section 252 of the Trade Expansion Act of 1962.

As a result of this investigation, we have found that since the 1960's, the EC has levied a higher duty on imports of citrus from the U.S. than that levied on imports from certain Mediterranean countries. The level of discrimination is significant. In some cases the U.S. pays a duty 5 times greater than that paid by other suppliers. This discriminatory tariff treatment has impaired the ability of U.S. citrus exporters to market their fruits in the EEC and is, in the view of the U.S., inconsistent with the EEC's obligations under the GATT.

Nevertheless, recognizing the political importance of these preferential tariffs to the EEC, the United States made extensive efforts over the course of a number of years to resolve the matter through bilateral consultations rather than mount a legal challenge against the EEC in the GATT. The U.S. also tried to resolve this issue in the context of tariff concessions granted during the Tokyo Round of Multilateral Trade Negotiations. With

the exception of a few minor tariff reductions resulting from the Tokyo Round, these efforts were without success. Following the conclusion of the Tokyo Round, the U.S. initiated consultations under the provisions of the GATT, but the EEC again rebuffed all efforts to reach a compromise solution.

With any possibility of a negotiated settlement thus ruled out, the U.S. invoked the dispute settlement procedures of the GATT as the only alternative means of seeking a redress of our complaint. In 1983, a panel was established to review the U.S. complaint. Throughout this procedure, the U.S. has continued to demonstrate its willingness to seek a mutually acceptable solution to this problem. For example, the U.S. agreed to the unusual step of allowing the Director-General of GATT to attempt to arbitrate the dispute before pressing its request for formation of a dispute settlement panel. Unfortunately, the attempt failed. The EEC rejected all efforts at compromise.

In December, 1984, based on a voluminous record, the panel found unanimously that the EEC preferences nullified and impaired U.S. benefits arising under the GATT with respect to U.S. exports of oranges and lemons, two of the eight categories of U.S. citrus exports affected by the tariff preferences. The panel recommended that the EC reduce its MFN rate of duty on fresh oranges and lemons no later than October 15, 1985.

Although the panel did not rule on this issue, the United States continues to believe, that the EEC citrus preferences are inconsistent with the most-favored-nation principle of the GATT, and thus nullify or impair U.S. benefits with respect to exports

of the other citrus items as well as lemons and oranges. Nevertheless, the U.S. has been willing to accept the panel's more limited recommendation for the following reasons. The sole interest of the U.S. in bringing this issue to the GATT has been to obtain the elimination or reduction of a barrier to U.S. citrus exports. While the panel's recommendation does not call for the elimination of the barriers, we believe its implementation by the EEC would significantly increase access for key U.S. citrus exports to that market. Moreover, the panel's recommendation does not require the EEC to take action inconsistent with its preferential trading arrangements; indeed it would result in lower tariffs for the preference receiving countries as well.

The EEC, however, has been unwilling to accept either the panel's findings or recommendation and has effectively prevented a resolution of this issue in the GATT. Thus, U.S. attempts to resolve this problem at the bilateral or multilateral level have not succeeded.

In light of the results of the USTR's investigation, I believe we must recognize that the level of trade concessions between the U.S. and EEC is no longer in balance. We estimate that the value of annual U.S. exports of oranges and lemons would increase by more than $48 million if the EC had implemented the panel's recommendation.

The EEC's unwillingness to implement the panel's finding or to otherwise provide adequate compensation to the U.S. requires us to re-balance the level of concessions in U.S.-EC trade. Increasing the duty on pasta imports from the EC is a reasonable and appropriate means by which to achieve this.

ISSUE:

In accordance with the TPRG decision of March 27, and because the U.S. has been unable to resolve the citrus dispute either bilaterally or through the GATT, USTR is required, no later than May 30, 1985, to submit a recommendation to the President under Section 301. The recommendation is to call for the withdrawal of concessions on imports from the European Community equivalent to the loss in benefits to the U.S. arising from the EC's discriminatory tariff preferences until such time as a mutually acceptable resolution to this dispute is achieved. We must decide which EC products are to be subject to the withdrawal of concessions.

RECOMMENDATION:

USTR should recommend to the President that he increase the duty on the following two products as described below. The duty increase would apply only to imports of these products from the EC.

Commodity	TSUS No.	Present Duty	Proposed Duty
macaroni, not containing egg or egg products	182.35	.12¢/lb. (.5% AVE)	40% (equal to approx 10¢/lb)
macaroni, containing egg or egg products	182.36	.1¢/lb. (.25% AVE)	25% (equal to approx 10¢/lb)

RATIONALE:

Because the tariff preferences have been in existence for so long, it is difficult to quantify with precision the annual loss in orange and lemon exports caused by the preferences. We believe, however, that it is reasonable to assume we would have the same share of the EC market today that we held in the period prior to imposition of the preferences. Using a market share analysis, (See Appendix I) we estimate the trade loss at $48 million per year. In 1984 imports of pasta from the EC under the two categories above were valued at $29.4 million. (If imports from Spain and Portugal, who will soon be members of the EC are included, this number increases to nearly $29.6 million).

Duty increases of the magnitude proposed are expected to result in a sharp reduction of EC pasta exports to the U.S. However, this is not expected to have an adverse impact on U.S. consumers since imports are available form other sources and U.S. production accounts for the majority of U.S. consumption.

CLASSIFIED BY Claud T. Gingrich

DECLASSIFIED ON OADR

While withdrawing concessions with respect to these products does not offset the total estimated lost trade, we believe it constitutes an appropriate re-balancing of concessions for several reasons.

As noted above, the $48 million figure, while a best estimate, is only an estimate. It is possible the EC could raise credible arguments for using a lower figure. We wish to avoid a situation in which the President makes a maximum withdrawal of trade concessions based on a $48 M trade loss figure and then needs to adjust the withdrawal because of an adjustment to the trade loss figure. Moreover, our objective in this action is not to be punitive. Indeed, given the political sensitivity of this issue, a conservative action by the U.S. is appropriate.

By focusing on pasta, we limit the main impact to a single EC member, i.e. Italy. This should reduce the likelihood of other EC members, not affected by the pasta duty increase, supporting a retaliatory action by the EC with all the risks attendant upon an escalation of the dispute. It is appropriate to focus on Italy because, as the major EC producer of oranges and lemons, it has been the major stumbling block to a negotiated reduction of the EC duties.

Finally, by selecting pasta rather than other products, we are providing a remedy to an industry which has suffered from EC unfair trade practices. Despite a panel ruling that EC pasta subsidies are inconsistent with the Subsidies Code, this industry has also been denied the remedy to which it was entitled because the EC blocked adoption of the panel report. Thus action to raise tariffs on EC pasta exports to the U.S. both provides a remedy to the pasta industry and signals the EC that we will take reasonable actions to enforce our rights under trade agreements, when, through an abuse of process, the dispute settlement procedures of GATT cannot work.

GATT IMPLICATIONS:

Because the dispute settlement process has been deadlocked, we do not have GATT authorization to raise the duty on pasta. Without that authorization, the U.S. action could be successfully challenged as GATT inconsistent. We have retaliated without GATT authorization on only one previous occasion (1974 Cattle War with Canada). The U.S. believes it is nevertheless justified in taking this action in part because the panel unanimously ruled in our favor. Thus, we should not be surprised if other countries, faced with a situation in which a favorable panel report is blocked, take unilateral action.

We should also be prepared to decide whether further action by the U.S. (including possible retaliation) is needed in the event the EC retaliates against the U.S. for this action.

Despite these implications, the proposed action is appropriate. Inaction by the U.S. establishes the precedent that panel

reports can be blocked with impunity, thus undermining the integrity of the GATT system. It also invites Congressional action to deal with barriers to U.S. exports.

BACKGROUND:

Origin of the Dispute and Efforts to Negotiate a Solution

The EC's preferential tariffs on Mediterranean citrus imports have been the subject of several complaints by the U.S. industry. The first two complaints were filed in 1970 and 1972 under Section 252 of the Trade Expansion Act of 1962. The last was filed in 1976, under Section 301, alleging that EC preferences on oranges, tangerines, lemons, grapefruit, pectin, grapefruit segments, and orange, lemon, and grapefruit juice, were inconsistent with the MFN obligation of Article I.

Although the industry sought the elimination of the preferences, the U.S. followed a strategy of seeking MFN tariff reductions as a means of narrowing the preference. Through these efforts, the U.S. obtained some temporary duty reductions in the early 1970's and permanent duty reductions were obtained in the 1974 enlargement. The U.S. obtained further minor reduction in 1979 during the Tokyo Round. Since that time nine bilateral discussions were held during which the U.S. unsuccessfully offered tariff concessions in return for citrus tariff reductions.

Our extended bilateral efforts with the EC to resolve this issue have taken place in the context of the Casey-Soames understanding, which attempted to address U.S. trade problems in citrus caused by the preferences while recognizing the importance of the preferences to the EC. Among other things, this understanding called for: 1) the EC to eliminate reverse preferences with specified LDC's; 2) the U.S. to agree not to question the Article XXIV consistency of the EC arrangements; and 3) the EC to seek solutions where the preferences caused problems for U.S. trade interests. Because of this accommodation, the U.S. for years resisted a direct GATT challenge of the preference agreements, relying instead on multilateral negotiating opportunities and bilateral discussions under the Casey-Soames understanding to resolve the problem. Indeed, the U.S. stretched the interpretation of the time limits added to Section 301 in 1979 nearly to the breaking point in order to avoid breaching Casey-Soames.

During consultations under Article XXII and XXIII, the EC rebuffed all efforts at compromise. The EC took the position that the preferences had not, in fact, caused problems. The EC Commission maintained also that it did not have, and would not seek, negotiating authority on this issue from the Member States.

Initiation of GATT Dispute Settlement Procedures

With any chance of a negotiated settlement thus ruled out, the TPC, on November 12, 1981, decided to pursue dispute settlement in

the GATT as the only alternative. A last-ditch effort to arbitrate this dispute was made by the Director-General of GATT in August-September 1982. However, the EC rejected all offers of compromise. A panel was established in 1983 and in December, 1984 ruled unanimously that the EC preferences had nullified U.S. benefits under GATT with respect to exports of oranges and lemons.

In January 1985, prior to submission of the panel report to the GATT Council, the EC informed the U.S. that it intended to block adoption. On the fringes of the Kyoto Quadrilateral meeting, the USTR again suggested to EC Commissioner De Clercq that a solution be negotiated. De Clercq rejected the proposal.

When the GATT Council took up the citrus report on March 12 and April 30 the U.S., supported by some other CP's, proposed adoption of the panel report and recommendation. The EC and preference recipients strongly criticized the report and opposed adoption. U.S. offers to drop the report if the EC carried out the recommendation met with no response. Moreover, further diplomatic efforts to resolve the issue, including a letter from Secretary Schultz to foreign ministers of the EC member states, have been unsuccessful in convincing the EC to negotiate.

The EC's view is colored by its commitment to maintain a special trade relationship with the Mediterranean preference recipients for economic and political reasons. In the face of the erosion of the value of the current preferences by Spanish accession to the EC in 1986, the present EC members have accepted the EC reasoning that further concessions to the U.S. are impossible. The dispute settlement procedure has thus reached an impasse and cannot resolve the dispute.

TPRG ACTION:

On March 27, the TPRG considered what action to take in the citrus case. The TPRG noted that in the panel's view the EC preferences had, in effect, upset the balance of trade concessions between the U.S. and EC and that under such circumstances the U.S. would be entitled to re-balance the level of concessions by withdrawing specific concessions to the EC. The TPRG also recognized that because the EC was blocking the GATT process, the U.S. did not have specific GATT authorization to withdraw concessions and that the EC could therefore challenge the legitimacy of a U.S. withdrawal such as that proposed with respect to pasta. In such circumstances, the EC would likely receive a favorable panel finding. If so, we would link the two panel findings, not allowing one to be adopted without the other. The EC could, of course, also immediately retaliate against the U.S. without GATT authorization (in doing so, it would lack not only GATT approval but also the moral support of a favorable panel finding). Nevertheless, the TPRG believed that reasonable action to re-balance the level of concessions was appropriate to enforce U.S. rights under the GATT if the EC would not negotiate a solution. In the TPRG's view, lack of action would be detrimental to our interests because it would sig-

nal GATT members that Panel reports can be blocked with impunity and would revive Congressional efforts to make 301 action mandatory.

Therefore, the TPRG agreed to deem dispute settlement ended (and thus trigger the 30-day statutory deadline for a recommendation to the President) at the April 30 GATT Council meeting if the EC continued to block the report. It also directed that maximum efforts be made to negotiate a solution with the EC. Finally, it directed the 301 Committee to propose withdrawals of concessions on appropriate EC products.

As noted above, all diplomatic efforts to resolve the issue have failed and the April 30 GATT meeting ended in a deadlock.

On May 10, USTR held a public hearing on the issue of what recommendation should be made to the President. Testimony in favor of withdrawal of concessions was given by the California-Arizona Citrus League, Sun-Diamond and the National Pork Producers' Council. The Florida Citrus Commission advocated establishment of an international commodity arrangement for citrus to deal with a wide range of citrus issues, including preferences. The Commission stated it would not oppose a withdrawal of concessions if efforts to negotiate such an agreement failed. USTR also received testimony favoring withdrawal of concessions from the American Farm Bureau Federation, the International Apple Institute, the Northwest Horticultural Council, and the National Pasta Association and the National Association of Growers and Processors for Fair Trade, the California Farm Bureau Federation, the Cling Peach Advisory Board and a number of Members of Congress.

Testimony in opposition to withdrawal of trade concessions with respect to specific products has been received from the National Association of Beverage Importers and the French Federation of Wine & Spirits Exporters (wine, spirits and beer); Mars, Incorporated, Commerce Foods Inc., the Food & Confectionery Group of the American Association of Exporters and Importers, and Peter Paul Cadbury, Inc. (candy); the International Bottled Water Association and the Perrier Group (mineral water); the Apple Group of the Association of Food Industries (apple juice); and the National Association of Specialty Food Trade (specialty food items, wines & candy). Only the last group opposed restrictions on pasta on the grounds that its members, as importers, would be adversely affected by import restrictions.

APPENDIX I

Citrus Case: Withdrawal of Concessions

Calculation of Lost Trade

Using a market share approach as described below, the trade loss resulting from EC preferences is 17,499,000 for oranges and 30,707,500 for lemons for a total trade loss of $48,206,500.

EC Imports of Oranges

	TOTAL (Vol.) (000 MT)	U.S. Vol. (000 MT)	U.S. %	Preference Countries Vol. (000 MT)	Preference Countries %
1966-69*	2039	67	3	1,684	83
1981-83	1622	18	1	1,349	83

If U.S. had maintained 3% share of 1981-83 market, it would have sold a total of 48,700 MT's or an additional 30,700 MT's over the 18,000 actually sold. Assuming a price of $570/MT, the trade loss on these additional tons amounts to $17,499,000.

EC Imports of Lemons

	TOTAL (Vol) (000 MT)	U.S. Vol. (000 MT)	U.S. %	Preference Countries Vol. (000 MT)	Preference Countries %
1966-68	117	45	38	66	56
1981-83	267	15	6	228	85

If U.S. had maintained 38% share of the 1981-83 market, it would have sold a total of 101,500 MT or an additional 86,500 MT over the 15,000 actually sold. Assuming a price of $355/MT, the trade loss would be $30,707,500.

*1968 was excluded because it was a freeze year.